APPENDIX.

Dissenting Opinion.

[L. A. No. 22341. Jan. 5, 1954.]

CARTER, J.—I dissent.

It is my considered opinion that certain portions of section 834 of the Corporations Code, as applied here, are unconstitutional, particularly the requirement that plaintiff shareholder in a derivative suit furnish security for the expenses of individual defendants who are sued, not as officers or employees of defendant corporation, but as third persons who dealt with the corporation. Such a provision is violative of the equal protection clause of the federal Constitution (U. S. Const., Amendment XIV, §1) and the provisions of the California Constitution against special laws (Cal. Const., art. IV, 25).

Section 834 provides that within 30 days after service of summons in a shareholder's action the corporation *or other defendant* may move the court for an order requiring plaintiff shareholder to furnish security for the reasonable expenses, including attorney's fees of the corporation and the moving party which will be incurred in the defense of the action. This means that as a condition precedent to the maintenance of the action a stockholder plaintiff can be required to post security not only for the corporation's expenses but also for the expenses, including attorney's fees, *of third party defendants who are neither officers, directors, nor employees of the corporation.* It is in this respect that I would hold the statute unconstitutional as a denial of equal protection.

The majority recognizes the fact that this precise question has never yet been decided, as it states: "However,

inasmuch as some of the particular aspects of plaintiff's arguments as to the constitutionality of a provision for security for and possible indemnification of an individual defendant who is not sued as an officer or employe of a corporation appear to be advanced in this case for the first time we give specific consideration to those aspects of his arguments." In spite of this, the majority opinion proceeds to merely gloss over the issue by inadequately discussing the principal constitutional objection and then saying: "Fundamentally, plaintiff's arguments as to constitutionality are answered, either directly or by necessary implication, by Cohen v. Beneficial Industrial Loan Corp. . . ." Following this statement it admits that the New Jersey statute, involved in the Cohen case, "(. . . so far as appears, . . . contained no provision as to, and the opinion does not discuss, individual defendants who were officers or employes) . . ."

In the case of Cohen v. Beneficial Industrial Loan Corp., *supra,* 337 U. S. 541, the United States Supreme Court upheld a statute requiring security to be posted *for the corporation* when a shareholder brings a representative suit. The court there held that such a classification was a proper one since the shareholder can be required by state legislation *to protect the corporation he seeks to represent.* It said: "And while the stockholders have chosen the corporate director or manager, they have no such election as to a plaintiff who steps forward to represent them. He is a self-chosen representative and a volunteer champion. The Federal Constitution does not oblige the state to place its litigating and adjudicating processes at the disposal of such a representative, at least without imposing standards of responsibility, liability and accountability which it considers will *protect the interests he elects himself to repre-*

*sent."** (Emphasis added.) Thus it would appear that it may be proper for a state to require a stockholder plaintiff to protect the *interests he is representing* by posting security, but this cannot be construed to mean that he is to protect all interests including the third party defendants against whom he proceeds. The majority also cites Hogan v. Ingold, 38 Cal. 2d 802 [243 P. 2d 1], as answering "either directly or by necessary implication" plaintiff's arguments as to the constitutionality of section 834 but it follows this by saying: "(in which the problem as to such individual defendants did not arise). . . ."

The majority seems to feel that it is not essential to make a complete study of this constitutional question as is illustrated by the following statement: ". . . regardless of the propriety of the order requiring deposit of security for the individual defendants, the judgment of dismisal is, for another and independent reason, the only proper judgment here. Plaintiff failed and refused to furnish the security for the corporation as ordered. . . . Therefore, when plaintiff refused to deposit the security required for the corporation, the action could not continue against that indispensable party, or in its absence against any other party, and the trial court had no alternative but to dismiss as to all defendants." This argument is misleading as it overlooks the fact that even if plaintiff had posted security for the corporation he still would not have been able to proceed against the other defendants without first furnishing the security prescribed as to them. In view of this and the fact that grave questions of constitutionality were in-

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*This closing quotation mark was apparently omitted inadvertently from the dissenting opinon of Justice Carter as reported in 42 A. C. 28, 30.

volved, plaintiff appears to have followed a proper course of action by appealing from the order of dismissal.

It is well recognized that the equal protection clause prohibits discriminating and partial legislation in favor of particular persons as against others in like condition. The United States Supreme Court has said that: ". . . equal protection and security should be given to all under like circumstances in the enjoyment of their personal and civil rights; that all persons should be equally entitled to pursue their happiness and acquire and enjoy property; *that they should have like access to the courts of the country* for the protection of their persons and property, the prevention and redress of wrongs, and the enforcement of contracts; that no impediment should be interposed to the pursuits of any one except as applied to the same pursuits by others under like circumstances; that no greater burdens should be laid upon one than are laid upon others in the same calling and condition. . . ." (Emphasis added; Barbier v. Connolly, 113 U. S. 27, 31 [5 S. Ct. 357, 28 L. Ed. 923].)

The equal protection clause does not prevent the Legislature from setting up different requirements for different types and classes of litigants; however, a state legislature may not arbitrarily select certain individuals for the operation of its statutes since such selection is obnoxious to the equal protection clause. Legislation which is directed toward certain limited individuals and not against others can only be sustained if the classification is a reasonable one based on adequate grounds.

Under the provisions of section 834, a situation is presented where the plaintiff in a shareholder's derivative suit may be required to pay the defendant's attorney's fees if he is unsuccessful, but the defendant is not required to pay plaintiff's counsel fees if the latter wins. Such a statute

gives one party greater rights and advantages than the other and is invalid unless there is some adequate reason why third party defendants should receive different treatment than the plaintiff shareholder. No such adequate reason has been advanced by the majority and I am convinced the legislation is arbitrary and a denial of the equal protection of the law in that the classification is an unreasonable one.

Discriminatory legislation of this type was held unconstitutional in Builders' Supply Depot v. O'Connor, 150 Cal. 265 [88 P. 982, 119 Am. St. Rep. 193, 17 L. R. A. N. S. 909]. In that case the mechanic's lien law provided for attorney's fees only to those who established their claim under said law and not to those who successfully resisted such claim of lien. In holding such a law unconstitutional this court (p. 268) said: "This provision is in our opinion violative both of the federal and the state constitution —of the fourteenth amendment of the former, which guarantees to every person 'the equal protection of the law,' and of the provisions of the state constitution which provide that general laws shall be uniform, prohibits special laws, and declare the inalienable rights of all men of acquiring, possessing, and protecting property. A statute which gives an attorney's fee to one party in an action and denies it to the other, and allows such fee in one kind of action and not in other kinds of actions where, as in the statute here in question, the distinction is not founded on constitutional or natural differences, is clearly violative of the constitutional provisions above noticed."

If plaintiff did furnish security and the action were prosecuted to judgment the individual defendant, under section 834, could recover attorney's fees from plaintiff if they prevailed but plaintiff could not recover such fees

from the individual defendants if he prevailed. What sound basis can there be for the provision in section 834 which gives a third party defendant, who is not an officer or employee of the defendant corporation, this preferential treatment? Merely because an individual defendant is sued in a derivative suit does not put him in any substantially different position than if he had been sued directly by either the corporation or by plaintiff and for this reason he should not be entitled to any special consideration. It is true that the corporation shall be responsible for the costs and counsel fees of a plaintiff who has successfully maintained a shareholder's derivative suit but this does not remedy the situation since the plaintiff is still put to the disadvantage and expense of posting security for a defendant who is under no corresponding disadvantage.

Even if the shareholder could ultimately prevail, this requirement of an advance security for each individual defendant might impose such a severe financial strain upon the shareholder that he would be unable to raise the money and consequently be unable to continue with the derivative suit. In the instant case the trial court required a bond of $5,000 for each individual defendant. What if there had been 20 or more such defendants? How many small shareholders are in a position to post security bonds of $100,000 or more? As a practical matter a requirement of this type would keep most small shareholders from bringing derivative suits and is therefore highly discriminatory.

It has been said that the purpose of statutes of this type is to protect corporations, their directors, officers and employees against so-called "strike suits" and the litigation expenses which may be unjustifiably foisted upon them; however the California legislation goes beyond this in that

it imposes liability on the plaintiff for the expenses of successful stranger defendants under certain conditions.

It is frequently argued that the posting of such security in favor of the corporate defendant is justifiable since where the shareholder elects himself as the champion of the corporation's cause of action he should be liable for any expenses which he brings about should he be unsuccessful. (See Cohen v. Beneficial Industrial Loan Corp., *supra*, 337 U. S. 541.) Such an argument is not applicable where such special protection is given to a third party defendant who would be entitled to no special consideration if he had been sued directly by the corporation or by an individual plaintiff. The mere fact that the individual defendant is sued in a derivative suit does not put him at any greater disadvantage than if he were sued directly, and for this reason, he should not be entitled to special protection at the expense of the plaintiff shareholder.

Even prior to 1949 the California courts recognized that a plaintiff must meet certain requirements in order to maintain a shareholder's derivative suit. Such requirements were found necessary to protect corporations from the so-called "strike suits" or "shakedown suit" wherein a plaintiff sued primarily to harass the corporation into a pecuniary settlement. The early case of Whitten v. Dabney, 171 Cal. 621 [154 P. 312], helped to remove a primary cause of the strike suit by holding that once commenced a stockholder plaintiff could compromise his suit only under the strict surveillance of this court. However, in 1949 with the passage of section 834, the California Legislature went even further in the curtailment of stockholder's derivative suits. The California legislation was in part patterned after the New York Act (N. Y. Gen. Corp. Laws,

§61) but it went far beyond its predecessor in the requirement that plaintiff can now be held liable for the expenses of successful stranger defendants under certain conditions.

The primary purpose of legislation of this type has been said to be "to protect corporations, their directors, officers, and employees against so-called 'strike suits' and the litigation expenses which may be unjustifiably foisted upon them." (Ballantine, *Abuses of Shareholders Derivative Suits: How Far is California's New "Security for Expenses" Act Sound Regulation?* 37 Cal. L. Rev. 399.) In order to carry out this purpose the New York Law (N. Y. Gen. Corp. Laws, *supra*, §61), the New Jersey Law (N. J. Stat. Ann., tit. 14, §§3-14) and the Pennsylvania Law (Pa. Stat. Ann., tit. 12, §§1321 and 1323) each provides that the shareholder plaintiff post security for the expenses of the corporation and the other defendants for whose costs the corporation may be liable (*i. e.*, directors, officers and employees). However, they do not require that he post security for the expenses of third person defendants who are neither directors, officers nor employees of the corporation since the corporation which plaintiff elects to represent would not be liable for such expenses. In California section 834 purports to go considerably further than the laws of its sister states in requiring the plaintiff shareholder to be liable for the attorney's fees of third party defendants even though the corporation itself could not be held liable for such expenses. Such a provision is not only unwarranted but it is a denial of the equal protection of the laws since it requires the plaintiff shareholder to post security for the third party defendant's attorney's fees without imposing a corresponding liability on the third party defendant.

Some authorities hold that it is a prudent precaution to attempt some reasonable regulation of derivative actions to prevent strike suits, but I feel that the rule of Whitten v. Dabney, *supra,* 171 Cal. 621, (limiting the shareholder's right to settle derivative suits once commenced) and the provisions of section 834 requiring security for the corporation's expenses are sufficient. I see no sound reason why the plaintiff shareholder should be further limited by having to post security for the expenses of third party defendants.

Granting that some restrictions are necessary it should be remembered that "Great evil, however, will result if undue obstacles are placed in the path of a shareholder who has legitimate grounds for suing. The derivative action is practically the only remedy for calling the management to account for its wrongs against the corporation and to obtain restitution." (Ballentine, *Abuses of Shareholders Derivative Suits, supra,* 37 Cal. L. Rev. 399, 416.)

For these reasons I feel there is no adequate basis for the discriminatory provisions of section 834; that they violate the equal protection clause of the Fourteenth Amendment to the Constitution of the United States and constitute an undue impediment to the very necessary stockholder's derivative suit. It must be remembered that the reported decisions of this court show many instances in which stockholders of corporations have been defrauded and that many derivative suits have been meritorious.

I would therefore reverse the judgment of dismissal.